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Uniform Commercial Code--Assignments--Conditional Sales Contracts--Waiver of Defense Claims

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one of contraception,[32] but one of conception and the paramount right to life that attaches thereto.

As early as 1949, the Virginia Supreme Court viewed anti-abortion legislation in this perspective: "Anti-abortion statutes are enacted, not only for protection of the woman, but for protection of the unborn child and society . . . ."[33] However intimidating the population bomb may become, however deafening the public clamor for open abortion,[34] the courts cannot properly abandon the fetus to the whim of circumstances—even in the first three months of gestation. Reason, not rationalization, must be the guardian of human life.

William T. Robinson III

UNIFORM COMMERCIAL CODE—ASSIGNMENTS—CONDITIONAL SALES CONTRACTS—WAIVER OF DEFENSE CLAUSES.—O. G. Jennings purchased a car from an automobile dealer under a conditional sales contract which embodied a "waiver of defense or counterclaim" clause.[1] The contract received the customary treatment of such agreements, assignment to a finance company. Apparently upon default of payments, the assignee repossessed and sold the car, bringing suit against Jennings to recover the deficiency on the unpaid balance. The trial court granted summary judgment for the assignee, disallowing a counterclaim that the retailer had delivered a used car misrepresented as a new one.[2]

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[32] Lucas, *supra* note 21.

[33] Miller v. Bennet, 190 Va. 162 —, 56 S.E.2d 217, 221 (1949).

[34] The trend of public opinion is clear:

> Whatever the underlying motivation, public attitudes about abortion have changed rapidly. In 1967, a Gallup poll showed that 21 percent of Americans felt abortion should be permitted for any woman wanting one. In a Gallup study last year, four out of ten persons said they regarded abortion as a private matter between a woman and her doctor. *Abortion and the Changing Law*, NEWSWEEK, April 13, 1970, at 54.

[1] It is standard procedure for car dealers to include "waiver" clauses in conditional sales contracts. To obtain enough ready cash to restore inventory, dealers assign (sell) their right to collect under a sales contract to financial institutions at a discount. The following clause was embodied in the sales contract of the instant case:

> If Seller assigns this contract, Seller shall not be assignee's agent for transmission of payments or for any purpose; Customer will settle, directly with Seller, all claims, defenses, set-offs and counterclaims there may be against Seller, and not set up any thereof against assignee. Upon full payment of Customer's obligation, assignee may deliver all original papers, including any certificate of title to Seller as Customer's agent. 442 S.W.2d at 566.

[2] The effect of the UNIFORM COMMERCIAL CODE [hereinafter UCC in the footnotes] § 9-206(1), which provides for the use of "waiver" clauses, is to make the assignee of the contract the holder in due course of a negotiable instrument. As such, he is free from certain "personal" defenses such as a failure of consideration. Receiving a used rather than a new car is a failure of consideration. *See* UCC § 3-305.

Jennings appealed. *Held*: The "waiver of defense" clause is consistent with Article 9-206(1) of the Kentucky Commercial Code and not contrary to public policy.[3] *Jennings v. Universal C.I.T., Credit Corporation,* 442 S.W.2d 565 (Ky. 1969).

Contractual waiver of defense has been a troublesome area of law throughout much of the twentieth century, primarily because of the continuing growth in credit purchases.[4] The problem has two justifiable points of view, much like the proverbial coin. In order to obtain enough ready cash to restore inventory, honest businessmen need sales contracts which are readily assignable. If the contract contains a waiver clause immunizing the assignee from lawsuits over performance of the contract, it is more easily assignable and therefore more valuable. Posed against this commercial advantage is the necessity of giving some protection to the consumer,[5] who has little bargaining power over clauses in standard form contracts,[6] but who will ultimately suffer by waiving all personal defenses against the assignee. The rather severe consequences that flow directly from the waiver clause may be summarized as: (1) placing on the buyer the risk of the seller's possible insolvency because the buyer must pay the assignee regardless of performance; (2) putting the burden on the buyer to locate the seller and bring suit against him; and (3) depriving the buyer of the possibility that by refusing to make payments on defective goods, he could force the seller to comply with the terms of the contract. From the vantage point of creating respect for the law, the problem is further magnified when the consumer simply cannot comprehend that he could be required to pay the finance company when a fly-by-night dealer has not delivered his color TV, or has become insolvent before delivery.[7]

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[3] Although beyond the scope of this comment, the case was actually reversed and a new hearing granted on a procedural point. Summary judgment should not have been granted because an issue was successfully raised as to whether there was a default in payments to justify repossession.

[4] The Federal Reserve Board reported the increase in installment credit, to the end of February, 1969, at 89.4 billion dollars. Total consumer credit was 111.6 billion dollars. This latter figure includes loans to individuals for household and family expenses, excluding real estate mortgage loans. 55 FED. RESERVE BULL. A52 (April 1969).

[5] In the broad sense, every buyer is a consumer. But it has been the practice to differentiate buyers who utilize the goods for business purposes from buyers of more personalized items. UCC § 9-109 specifies that goods are "consumer goods" if they are bought for use primarily for personal, family or household purposes. These are separated in treatment from equipment, farm products and inventory.

[6] Freedom of contract is beneficial to all when it exists in truth. However, in the field of consumer goods, as in the labor market, this is more fancy than fact. Hollander, *Consumer Perspective and Consumer Sales Under the U.C.C.*, 21 N.Y.U. INTRA. L. REV. 241 (1966).

[7] Jones, *Consumer Protection—The Role of Cut-Off Devices*, 1968 Wis. L. Rev. 505, 525-26 (1968). Cf. Note, *Can The Kentucky Consumer Ever Forget Caveat Emptor and Find True Happiness?*, 58 KY. L. J. 325, 336-47 (1970).

There is real difficulty in determining from the early decisions majority and minority views with regard to the rights and duties of the assignees of conditional sales contracts.[8] Without regard to the difference between consumer and commercial sales, a few courts outlawed all waiver clauses as an affront to public policy.[9] Others reached an opposite result by relying on theories of laissez-faire.[10] Today many states, recognizing waiver clauses in general, have enacted laws especially dealing with consumer problems. These may completely void contractual waiver of defenses as out of place in the consumer field.[11] A more creditor-oriented approach has been to provide for notice of assignment to the buyer, and for a delayed period before the clause can become effective.[12] This provides the consumer with only a limited opportunity to notify the assignee of defects in the goods and preserve his defenses. The proposed Uniform Consumer Credit Code [hereinafter U3C], thus far enacted in only two states,[13] substantially provides for either of the above methods that the adopting state might prefer.[14]

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[8] Note, *Finance Company As A Holder In Due Course*, 51 KY. L. J. 134, 139-40 (1962).

[9] Equipment Accept. Corp. v. Arwood Can Mfg. Co., 117 F.2d 442 (6th Cir. 1941); San Francisco Sec. Corp. v. Phoenix Motor Co., 25 Ariz. 531, 220 P. 229 (1923); American Nat'l Bank v. A. G. Sommerville, Inc., 191 Cal. 364, 216 P. 376 (1923); Quality Fin. Co. v. Hurley, 337 Mass. 150, 148 N.E.2d 285 (1958); Industrial Loan Co. v. Grisham, 115 S.W.2d 214 (Mo. App. 1938); Old Colony Trust Co. v. Stumpel, 126 Misc. 375, 213 N.Y.S. 536 (Sup. Ct. 1926), *aff'd mem.*, 219 App. Div. 771, 220 N.Y.S. 893 (1 Dept. 1927), *aff'd mem.*, 247 N.Y. 538, 161 N.E. 173 (1928); Motor Contract Co. v. Van Der Volgan, 162 Wash. 449, 298 P. 705 (1931).

[10] United States ex rel. Adm'r v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940); Refrigeration Discount Corp. v. Haskew, 194 Ark. 549, 108 S.W.2d 908 (1937); Hartford-Connecticut Trust Co. v. Clark Barone Co., 21 Conn. Sup. 368, 154 A.2d 883 (1959); Jones v. Universal C.I.T. Credit Corp., 88 Ga. App. 24, 75 S.E.2d 822 (1953); Commercial Credit Corp. v. Baigi, 11 Ill. App. 2d 80, 136 N.E.2d 580 (1956); Cotton States Mut. Ins. Co. v. Bibee, 147 W. Va. 786, 131 S.E.2d 745 (1963). *See* Annot., 51 *A.L.R.*2d 895 (1957).

[11] ALAS. STAT. § 42.10.140 (1962); CAL. CIV. CODE § 1804.2 (West Supp. 1967); HAWAII REV. LAWS § 201A-17(d) (Supp. 1965); PA. STAT. ANN. tit. 69, §§ 615 (F), (G) (Purdon 1965); VT. STAT. ANN. tit. 9, § 2455 (Supp. 1967); WASH. REV. CODE ANN. § 63.14.150 (Supp. 1967).

[12] DEL. CODE ANN. tit. 6 § 4312 (Supp. 1966) (15 day delay period); ILL. ANN. STAT. ch. 121-½, § 262D (Smith-Hurd Supp. 1967) (5 day delay period); MICH. COMP. LAWS ANN. § 445.865(d) (1967) (15 day delay period); N.Y. PERS. PROP. LAW § 302(9) (McKinney Supp. 1967) (10 day delay period); TEXAS REV. CIV. STAT. ANN. art. 5069-6.07, –7.08 (Vernon Supp. 1967) (30 day delay period).

[13] To date only Utah and Oklahoma have adopted the UCCC, For a full discussion of the Oklahoma law see Comment, *Consumer Credit Sales and the Oklahoma Uniform Consumer Credit Code*, 6 TULSA L. J. 20 (1969).

[14] *See* Hogan, *Integrating the UCCC and the UCC–Limitations on Creditors' Agreements and Practices*, 33 LAW & CONTEMP. PROB. 686 (1968). For a short summary see Murphy, *Another Assault Upon The Citadel: Limiting The Use of Negotiable Notes and Waiver Clauses in Consumer Sales*, 29 OHIO ST. L. J. 667 (1968). *See Uniform Consumer Credit Code* [hereinafter U3C] § 2.404 (Alterna-

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In states like Kentucky, reluctant to adopt progressive consumer legislation, the whole problem is relegated to the more general provisions of the Uniform Commercial Code [hereinafter the Code]. The 1952 draft of the Code took a strong position in favor of the consumer.[15] It prohibited the assignee from cutting off the buyer's defenses either by use of a waiver clause in the assigned contract, or as a holder in due course of a negotiable note.[16] The 1957 revision of the Code, adopted in Kentucky,[17] modified its position so as to permit waiver clauses, but with a controversial limitation where consumer goods were involved. Code Section 9-206 now provides:

> (1) *Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods,* an agreement by a a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement. (2) When a seller retains a purchase money security interest in goods the Article on Sales (Article 2) governs the sale and any disclaimer, limitation or modification of the seller's warranties.[18] (emphasis added)

A literal reading of Code Section 9-206(1) might suggest that a waiver clause is to be effective as to consumer goods, unless there is a prior statute or decision to the contrary. A number of text writers and at least one court have accepted this construction.[19] The Code,

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tive A and Alternative B). For a comparative critique of these U3C Alternatives see Note, *Can The Kentucky Consumer Ever Forget Caveat Emptor and Find True Happiness,* 58 Ky. L. J. 325, 358-60 n. 194 (1970).

[15] *See, e.g.,* Spivock, *In Re Article* 9, 28 TEMP. L. Q. 603 (1955); Annot., 44 A.L.R.2d 162 (1955).

[16] UCC 9-206(1) (1952 version) provides:

> An agreement by a buyer of consumer goods as part of the contract for sale that he will not assert against an assignee any claim or defense arising out of the sale is not enforceable by any person. If such buyer as part of one transaction signs both a negotiable instrument and a security agreement even a holder in due course of the negotiable instrument is subject to such claims or defenses if he seeks to enforce the security interest either by proceeding under the security agreement or by attaching or levying upon the goods in an action upon the instrument.

[17] The UCC as enacted in Kentucky can be found in KY. REV. STAT. [hereinafter KRS] § 355.1-101—10-104 (1968).

[18] UCC § 9-206 and KRS § 355.9-206 are the same.

[19] *See* 15 AM. JUR.2d Commercial Code § 58 (1964); Comment, *Assignments-Maker's Defense Cut Off—Uniform Commercial Code § 9-206,* 5 NAT. RESOURCES J. 408 (1965). The problem also came up in General Elec. Credit Corp. v. Noblett, 268 F.Supp. 984, 986-87 (W.D. Okla. 1967).

however, has an inherent ambiguity which has created confusion and is likely to result in less than uniformity of decision.

The drafter's official comment to Section 9-206(1) implies that the provision in the preambular clause for the superiority of a statute or decision to the contrary does not require that either be prior to the Code. Rather it is the drafter's way of having the Code take "no position on the controversial question" of the validity of waiver clauses in consumer sales.[20] That comment states:

> *This article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note.* In some states such waivers have been invalidated by statute. In other states the course of judicial decision has rendered them ineffective or unreliable—courts have found that the assignee is not protected against the buyer's defense by a clause in the contract or that the holder of a note, by reason of too close connection with the underlying transaction, does not have the rights of a holder in due course. *This Article neither adopts or rejects the approach taken in such statutes and decisions, except that the validation of waivers in subsection* (1) *is expressly made "subject to any statute or decision" which may restrict the waiver's effectiveness in the case of a buyer of consumer good.* (emphasis added)

The Legislative Research Commission of Kentucky, in a study authorized by the General Assembly pursuant to the adoption of Code, apparently accepted the drafters' comment as the authoritative interpretation. It further noted that "[s]uch clauses are only validated outside the consumer field."[21]

New Jersey implicity followed this approach when, there being no prior statute or decision to the contrary, its highest court declared in *Unico v. Owen*[22] that such waivers are unconscionable and against public policy. Section 2-302 of the Code authorizes courts to refuse to enforce any clause that they find unconscionable. Reading that section together with the comment to Section 9-206(1), the New Jersey court concluded this situation to be one of the rare instances where the legislature sanctions a broad judicial discretion. The *Unico* decision has been called the possible future trend in interpreting that facet of the Code.[23]

Before *Jennings*, Kentucky had not been squarely faced with the consumer problem arising under Section 9-206(1). Strangely, the

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[20] UCC § 9.206, comment 2.

[21] KY. LEGISLATIVE RESEARCH COMM., UNIFORM COMMERCIAL CODE, ANALYSIS OF EFFECTS ON EXISTING KENTUCKY LAW, RESEARCH PUB. NO. 49, p.355 (1957).

[22] 50 N.J. 101, 232 A.2d 405 (1967).

[23] Jones, *supra* note 7, at 517. *See* U3C 2.404, Comment 1.

Court's opinion does not differentiate between consumer and commercial sales, a distinction vital to a proper disposition of the problem involved. Nonetheless, it is clear Jennings partially grounded his defense on the allegation that since this vehicle was to be used for personal needs, the Code should void the waiver.[24] Without much discussion, the Court relied on prior Kentucky decisions under Section 9-206(1).[25] However, these cases all dealt with some form of equipment which the *Code* distinguishes from consumer goods.[26] Yet they do clearly indicate that no established public policy favors the consumer. In *Walter J. Hieb Sand and Gravel, Incorporated v. Universal C.I.T., Credit Corporation,* a pre-Code case cited in *Jennings,* the Court noted two statutes which seemingly demonstrated the validity of contractual waivers without regard to the type of transaction.[27] In passing, the *Hieb* court also examined the Massachusetts public policy against waiver clauses and found no counterpart in Kentucky.[28] The remaining cases cited in *Jennings* purport to follow *Hieb.*

Complete reliance on these cases could only indicate a predisposition toward a literal interpretation of Section 9-206(1) oblivious to the drafter's construction. Since the court found no statute or decision to the contrary it declined to create one, and the waiver clause in Jennings' contract was held to be effective.

Considering the legislative history of the Kentucky Code noted above, the case could have been decided differently.[29] But from the standpoint of sociological jurisprudence, the inquiry as to whether it should have been still remains. It is true that little harm results from

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[24] Brief for Appellant at 9, Jennings v. Universal C.I.T., Credit Corp., 442 S.W.2d 565 (Ky. 1969).

[25] Massey-Ferguson, Inc. v. Utley, 439 S.W.2d 57 (Ky. 1969); Root v. John Deere Co., 413 S.W.2d 901 (Ky. 1967); Morgan v. John Deere Co., 394 S.W.2d 453 (Ky. 1965); W. J. Hieb Sand & Gravel, Inc. v. Universal C.I.T., Credit Corp., 332 S.W.2d 619 (Ky. 1959).

[26] Subjects of commerce found in the few Kentucky cases decided under KRS 355.9-206(1) may include the following: (1) dump beds for trucks used in business (2) tractors and other farm machinery (3) plant machinery.

[27] 332 S.W.2d 619 (Ky. 1956). This case was decided after the adoption of the UCC but before its effective date. It held that KRS § 371.040 demonstrated a statutory policy which would uphold waiver clauses. That provision provides as follows:

> All bonds, bills or notes for money or property are assignable so as to vest the right of action in the assignee; but, except in the case of negotiable instruments, the assignment shall not impair the right to any defense, discount or set-off that the defendant has and might have used against the original obligee, or any intermediate assignor, before the defendant received notice of the assignment.

The Court also held that the UNIFORM SALES ACT (formerly KRS § 361.710), which existed in Kentucky prior to the UCC, allowed agreed variations of implied obligations usually incident to sales. 332 S.W.2d at 621-22.

[28] 332 S.W.2d at 621.

[29] *See* note 17 *supra,* and accompanying text.

a recognition of contractual waiver when personal defenses may be cut off by a merchant taking a negotiable note and assigning it to a finance company who becomes a holder in due course. But this begs the question, which is whether any legal device should exist which cuts off the consumer's resort to the courts and prohibits thereby a redress of real grievances. Indeed, an increasing number of states, either by statute or common law, are beginning to deny holder in due course status in consumer sales.[30]

The most potent argument against invalidating the waiver clauses comes from the nature of the finance industry itself. The only way many consumers can afford to purchase goods is by taking advantage of credit. If financial institutions are unwilling to discount conditional sales contracts without immunity from suits over the merchant's performance, then arguably it will be the consumer who suffers.[31] A more likely result seems to be that financing institutions would be forced to inquire more carefully into the integrity and capital structure of the merchants with whom they deal, just as they check credit ratings before making personal loans.[32] In a 1968 survey of Springfield, Massachusetts, where waiver clauses have long been considered against public policy, over 55% of responding financial institutions noticed no effect on their business as a result of this pro-consumer policy.[33] The study did point out, however, a slight shift from contract assignments to direct consumer loans. But here, at least, the buyer is more likely to realize that he must repay the loan, even if the goods are defective. When he procures credit through the merchant, the finance company appears as an agent of the seller.

On balance, the equities appear to be more on the side of the consumer. Even if the waiver clause does not appear hidden in fine print, the buyer will usually not understand its full impact. Nor is he able to bargain over its inclusion. If one doubts that real confusion exists in trying to understand the legal implications of installment buying, he need only notice the increasing number of consumer bankruptcies.[34] Further, litigation can be an expensive process when you must pay the assignee, search for an absconded salesman, and then sue the merchant on the contract. The financial institutions, who

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[30] By statute: MASS. GEN. LAWS ANN. ch. 225, § 12(c) (Supp. 1966); NEV. REV. STAT. § 97.275 (1967); N.M. STAT. ANN. § 50.16.5 (Supp. 1967); ORE. REV. STAT. § 83.650 (1968); PA. STAT. ANN. tit. 69, § 615 (F), (G) (Purdon 1965). At common law: Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967).

[31] Comment, *Waiver of Defense Clauses and Consumer Protection In Installment Sales Contracts*, 36 FORDHAM L. REV. 106, 107 (1967).

[32] King, *The Unprotected Consumer–Maker Under the Uniform Commercial Code*, 65 DICK. L. REV. 207, 211-13 (1961).

[33] Jones, *supra* note 7, at 524-25.

[34] 113 CONG. REC. 7520 (daily ed. May 31, 1967).

usually are closely connected with this seller, are better able to bear the risk of the seller's non-performance. In addition, they can shift the burden of non-performance to its creator, the seller, by discounting with right of recourse against the merchant or by holding some discount proceeds in a reserve fund to cover off-sets arising from the buyer's defenses.[35]

Undoubtedly, as *Jennings* indicates, we should have a clearer mandate from the General Assembly on consumer policy. Yet, the New Jersey court did not feel constrained by the language of the Code to throw the woolsack to the legislature.[36] Clearly, basic equity, as embodied in the Code's term "unconscionable," would require a construction of Section 9-206(1) the converse of that adopted in *Jennings*.

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[35] Bailey, *The Substantive Provisions of the UCCC: 20th Century Consumer Protection in a Free Enterprise System*, 29 OHIO ST. L. J. 597, 618 n.139 (1968).

[36] See text accompanying notes 22 and 23 *supra*.